IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 00-5362

FEDERAL TRADE COMMISSION,

Plaintiff-Appellant,

v.

H.J. HEINZ COMPANY, *et al.*,

Defendants-Appellees,

FEDERAL TRADE COMMISSION'S REPLY IN SUPPORT OF ITS EMERGENCY MOTION FOR AN INJUNCTION PENDING APPEAL

The district court committed substantial legal errors in denying the Federal Trade Commission ("Commission") the statutory remedy to which it is entitled under Section 13(b) of the Federal Trade Commission Act (15 U.S.C. § 53(b)) – a preliminary injunction in aid of an administrative proceeding in which the Commission would fully consider whether a proposed merger between the H.J. Heinz Company ("Heinz") and Milnot Holding Company ("Beech-Nut") would violate Section 7 of the Clayton Act. 15 U.S.C. § 18. The district court erred as a matter of law in denying the Commission a preliminary injunction under the standards established by this Court in *FTC v. PPG Indus., Inc.*, 798 F.2d 1500 (D.C. Cir. 1986); it wholly failed to address the merger's adverse effects in the primary market alleged by the Commission (the manufacture and sale of jarred baby food) and faulted Commission for not proving adverse effects in the downstream retail market; it wrongly credited modest efficiencies without finding that these efficiencies would redound in any way to the benefit of purchasers of jarred baby food; and it misweighed the equities by holding that defendants' threats to abandon their transaction in the face of a preliminary injunction trumped the court's own finding that:

> [I]f the merger is allowed to proceed before the full-scale administrative proceedings contemplated by the Federal Trade Commission Act can be had, the outcome of such proceedings will not matter, because [Beech-Nut's] Canajoharie plan will be closed, the Beech-Nut distribution channels will be closed, the new label and recipes will be in place, and it will be impossible as a practical matter to undo the transaction.

FTC App. F at 26-27.

The Commission has demonstrated a substantial likelihood of success on the merits of this appeal and that the public equities and other factors warrant an injunction so this Court can meaningfully assess the important issues raised by this appeal.[1]

I. The Commission Has Shown A Substantial Likelihood Of Success On The Merits Of This Appeal

A. This Court's Decision In *PPG* Compels The Granting Of Preliminary Relief In The Circumstances Of This Case

In *PPG,* this Court held that "[t]here [was] no doubt" the Commission was "entitle[d]" to "some preliminary relief." 798 F.2d at 1503. The Court did so in the presence of three controlling circumstances that are also present here -- high and stable market concentration; high entry barriers; and an acquired firm that was not about to fail. On that basis alone the district court should have entered a preliminary injunction here so the Commission could fully and fairly assess the merits of Heinz's and Beech-Nut's defenses on the basis of a full adjudicative record.

Nowhere does either appellee identify any respect in which the Commission fell short of

[1] Heinz faults the Commission for not reciting in its emergency motion the standards for securing emergency injunctive relief before this Court. Heinz Opp. at 5-7. Because those standards are expressly incorporated into Circuit Rule 8, and the Commission's motion closely followed the format required by that Rule, it was hardly necessary to elaborate on standards with which this Court is familiar.

the showing sustained by the Court in *PPG*. Beech-Nut ignores *PPG* entirely. Heinz simply drops a footnote suggesting that this Court somehow *sub silientio* overruled *PPG* in *United States v. Baker Hughes, Inc.*, 908 F.2d 981 (D.C. Cir. 1990). *See* Heinz Opp. at 9 n.5. That argument is untenable and does not support the district court's decision here. *PPG* and *Baker Hughes* are two entirely different cases that stand for two distinctly different propositions. *PPG* held that the Commission is entitled to a preliminary injunction when the acquired firm is not failing, and the Commission shows that entry barriers are high, and "that the relevant market . . . is already *'highly concentrated'* and [that] the effect of the acquisition would be a dramatic increase in concentration." 798 F.2d at 1503 (emphasis added). In that situation, the likelihood of permanent harm to competition is sufficiently great (and the Commission's chances of prevailing are so high), that any defenses – other than those addressed to concentration, barriers, and the acquired firm's viability – must be considered in the context of a full trial record.

In stark contrast, *Baker Hughes* -- a case appealed *after* a full trial on the merits -- holds that the government has the burden of proving high entry barriers (a burden the Commission met here), that the government is not entitled to permanent injunctive relief solely on the basis of high market shares that are "volatile and shifting" and "easily skewed" by a few large contracts (factors not present here), and that in a trial on the merits a district court is to consider all aspects of the transaction and the relevant markets in determining whether to grant a permanent injunction. 908 F.2d at 986, 987. Not one of the circumstances that dictated the outcome in *Baker Hughes* is present in this case.

It follows that nothing in *Baker Hughes* is inconsistent with *PPG*, particularly given the cases' different procedural postures. More important, it follows that nothing in *Baker Hughes* suggests the Commission is not entitled to the preliminary relief it sought below. The Commission met the governing standard set forth in *PPG*, and the court below should have granted the Commission a preliminary injunction.[2]

Unable to refute the Commission's showing on any of the dispositive factors in *PPG* – high industry concentration; the prospect of a dramatic increase in concentration; high entry barriers; and the lack of any indication of failing companies – defendants took on the Commission's strong prima facie case by attempting to show that competition at the wholesale level does not ultimately benefit retail consumers and by attempting to show that asserted possible efficiencies and various innovations would result from the merger. At least in cases that meet the *PPG* criteria, such arguments must be reserved for the merits proceedings. They are not suitable for final determination in the context of a necessarily truncated preliminary injunction hearing. But even if *PPG* (or *Baker Hughes*) allowed defendants to make such arguments at the preliminary injunction stage of this case, defendants' showings (and the district court's reliance on them) fail even on their own terms. Heinz and Beech-Nut failed to address competitive effects in the distribution market, and thereby wholly ignored half the Commission's case. And their efficiency arguments fail to show that any proven benefits will be passed on to purchasers, rather than used to enhance Heinz's bottom line.

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[2] Nor should this conclusion be altered in any way by the district court's casual observation that collusion between Heinz and Gerber is unlikely in the post-merger market. FTC App. F at 20, n.7. The extraordinary notion that coordination is improbable in a market with only two players is simply contrary to all known legal precedent. To reach this conclusion, nearly 40 years of merger enforcement -- dating to *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963) -- must be cast aside. This step should not be taken without a full evidentiary hearing on the merits by the Commission, as contemplated by Congress.

B. The District Court Failed To Address Competitive Effects In The Distribution Market

Section 7 makes unlawful mergers that may substantially lessen competition *in any line of commerce*. The record in this case indisputably establishes that Heinz and Beech-Nut are direct competitors in the manufacture and sale of jarred baby food at wholesale. Their abundant and vigorous competition is well documented in the record. As the district court observed at closing argument: "I can't disagree with the Commission's position that Heinz and Beech-Nut are competing and that a merger of the two companies will end that competition." FTC App. P at 31.

Rather than attempt to argue that the merger will not substantially lessen competition at the wholesale level, Heinz and Beech-Nut attempted to show that the merger would not affect retail consumers. The Commission responded both by proving harm at the distribution level,[3] and by countering defendants' argument with evidence showing that distribution competition affects retail competition. *See* FTC App. P at 143-44, 547, 551, 619-21, 845-46. The district court denied the Commission a preliminary injunction because the court believed that the Commission failed to show the merger would harm retail consumers. Although the district court overlooked ample evidence of likely consumer harm, the Commission's showing of substantially diminished competition in the wholesale line of commerce should itself have entitled it to a preliminary injunction.[4]

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[3] Given the district court's observation that "[b]y far the bulk of the evidence submitted by both parties concerned the nature and extent of distribution competition – the competition between Heinz and Beech-Nut to be the second brand on the shelf" (FTC App. F at 14-15), it is astounding that Heinz should try to camouflage the court's errors by arguing that the Commission is advancing a new theory here. *See* Heinz Op. at 2, 11-14.

[4] Even now, neither Heinz nor Beech-Nut denies the effects the merger will have at the distribution level. Indeed, Heinz boldly asserts that "the district court correctly considered the

The court committed clear legal error by faulting the Commission for a failure of proof in one market, while not addressing the unchallenged proof in the market alleged in the complaint. Given Section 7's condemnation of mergers that may substantially lessen competition in "any line of commerce," a preliminary injunction hearing is not the stage at which a court should finally determine (in a highly concentrated market with high entry barriers) that benefits in a downstream market outweigh the harm to competition in the primary market in which defendants compete.

C. The Court Erred In Crediting Defendants' Claimed Efficiencies

The district court believed that the merger would likely improve competition between Heinz and Gerber "[w]hen the efficiencies of the merger are combined with the new platform for product innovation" that the merger would create. FTC App. F at 23. Assuming for purposes of this emergency motion that the court was correct in its finding that the merger would presumably create a "new platform for innovation,"[5] its statement clearly shows a belief that the merger can only be saved by both efficiencies *and* innovation. But, as we have shown in our emergency motion, the district court erred as a matter of law in crediting the efficiencies in this case because it did not make the essential finding that the efficiencies will be passed on to purchasers or that

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effect of the merger on competition at wholesale" (Heinz Opp. at 12), but follows that assertion with a court finding about effects at the retail level: "This district court explicitly recognized that the '[t]he commission attempted to show that trade [retailer] spending competition between Heinz and Beech-Nut benefits consumers.'" *Id.*, quoting FTC App. F at 15.

[5] We intend to address the "innovation" argument fully in our merits brief and also show that the efficiencies found by the district court are not merger specific and should have been rejected. *FTC v. Cardinal Health*, 12 F. Supp.2d 34, 63 (D.D.C. 1998). As to innovation, suffice to say for now that the record shows that Heinz is already developing, or has developed, most all – if not all – of the "innovations" that it might introduce after the merger. Beech-Nut, for its part, has always been considered to be an innovative company, most recently being the first to remove various additives and to add various nutrients to its products.

they outweigh the anticompetitive effects of the merger in the alleged relevant market.

As the Horizontal Merger Guidelines instruct: "[e]fficiencies almost never justify a merger to monopoly or near monopoly" (¶ 4.0). As the district court observed in *FTC v. PPG Indus., Inc.,* "[e]xperience teaches that without worthy rivals ready to exploit lapses in competitive intensity, incentives to develop better products, to keep prices at a minimum, and to provide efficient service over the long term are all diminished to the detriment of consumers." 628 F. Supp. 881, 885 (D.D.C.), *aff'd in relevant part,* 798 F.2d 1500 (D.C. Cir. 1986); *see United States v. United Tote, Inc.*, 768 F. Supp. 1064, 1084-85 (D. Del. 1991) (rejecting efficiency defense in merger to duopoly; efficiencies insufficient to outweigh the loss of competition since "even if the merger resulted in efficiency gains, there are no guarantees that these savings would be passed on to the consuming public").

The absence of any meaningful competitors to a post-merger Gerber/Heinz duopoly after the merger means that no market forces will remain to force either Heinz or Gerber to compete to benefit their customers. The simple fact that defendants have shown efficiencies that might "enable" Heinz to lower the price of Beech-Nut and improve the quality of Heinz does not mean it will do so. Heinz could equally well just maintain the present price/quality mix, and pocket all of these savings in production and distribution costs. The district court cites no evidence, apart from the self-serving predictions of the parties, that the asserted efficiencies will be used to benefit customers. Moreover, defendants do not dispute that their claimed efficiencies would easily be overwhelmed by even a minimal anticompetitive price increase.

In highly concentrated markets with high entry barriers, such as jarred baby food, efficiencies and innovation are issues that should be resolved on the basis of a full evidentiary record. The district court committed grave legal error by failing to reserve that issue for the Commission's proceeding. These circumstances require an injunction pending appeal before the market is irrevocably altered by a merger than cannot be undone.

D. The District Court Incorrectly Weighed The Equities

Once the Commission has demonstrated a likelihood of success on the merits under Section 13(b), it is nearly impossible for a district court to justify anything less than a "full stop" preliminary injunction. *PPG,* 798 F.2d at 1506. The public equities in preserving competition during the pendency of an administrative proceeding greatly outweigh the parties' private equities in consummating their transaction before the issues have been fully adjudicated. As demonstrated above, the district court here found all the elements that *required* a full stop preliminary injunction in *PPG.* The court accordingly erred in finding that the defendants' private interests in consummating their transaction trump the public interest in preserving competition during the pendency of a Commission proceeding.

II. Other Factors Support An Injunction Pending Appeal

An injunction pending appeal will not cause defendants any cognizable harm. Both Heinz and Beech-Nut have proffered affidavits suggesting they might terminate their merger plans if this Court grants the Commission's motion. Heinz App. B; Beech-Nut App. Tab A. That, of course, is an event solely within defendants' control. But no court has previously held in the face of such arguments that the public interest in a fully adjudicated proceeding should be defeated by the threat of private parties to abandon a merger. *E.g., FTC v. University Health,* 938 F.2d 1206, 1225 (11th Cir. 1991) ("we think the public will be best served by enjoinment of this acquisition pending extensive analysis of its competitive effect.") In any event, as Beech-Nut has readily argued to this Court, Heinz is the only immediately available purchaser for the company. Beech-Nut Opp. at 6-7. Similarly, the trial record in this case strongly shows that Heinz's executives are enthusiastic about the transaction and look forward to acquiring their competitor – something they have long considered. *See* FTC App. K at 359. The record below belies defendants' claims that an injunction might cause them to abandon their merger.

In any event, the parties' claims of harm are highly suspect.[6] Beech-Nut, for example, bases its claim of harm on year-old data, a period during which it lost a major account, not to Gerber, but to Heinz. More significantly, neither party addresses the very real possibility that their worsening competitive situations may be caused by the likelihood that, during the pendency of their merger, they themselves have ceased to compete vigorously against each other (and therefore against Gerber).

But even accepting the parties' self-serving claims at face value, any minor setbacks they might endure during the pendency of an expedited appeal in this case pale in comparison to the very real harm to the public that would result from this merger going forward without meaningful, and timely, appellate review. Absent an injunction pending appeal, the parties will be free to consummate their transaction, combine the companies, close down plants, share confidential business information, and take other steps that could make it impractical to recreate pre-merger

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[6] Both parties' assertions of injury are premised on the ironic argument that Gerber – which they portrayed to the district court as a sleepy competitor – is posing a serious competitive threat to their respective positions. Heinz thus asserts that Gerber has "suddenly" developed 54 new product lines. Heinz App. B ¶ 8. Beech-Nut asserts that it is losing share to Gerber's intensified competitive efforts. Beech-Nut App. A ¶ 5. But at the preliminary injunction hearing, Mr. Meader, Beech-Nut's declarant here, acknowledged that Beech-Nut has been following Gerber's price increases because that is a profitable strategy. Tr. 922-23. In short, Beech-Nut may be eschewing greater volume for greater profits.

competition if the transaction ultimately is found to be illegal. Only by granting the requested relief can this Court maintain the status quo and assure that review is meaningful.

Conclusion

For the above-stated reasons, the Court should grant an injunction pending appeal, set an expedited briefing schedule, and set the case for argument at the earliest time that is convenient to the Court.

Respectfully Submitted,

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